

INCORPORATED IMMOBILIZED ACTIVES: IMPORTANCE, VALUATION, REVALUATION

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Abstract. In this article, we tried to display two problems. The first problem refers to the fact that, for the incorporated actives, it is stipulated in the law that the subsequent valuations are performed starting with the historic cost, except the amortization and the adjustments in case of devaluation, cumulated. This method has been inspired by the basic accounting treatment foreseen by IAS 38. The second problem relates to the fact that the application of the alternant accounting treatment, when revaluing the incorporated actives starting from the just value, is not only forbidden by the legal regulations from our country, but also perceived as a little further in time until the adoption, mainly because the just value must be reported at an active market.

Keywords: incorporated immobilizations, recognition, initial valuation, revaluation, subsequent valuation, schedule of assets and liability valuation

The unsatisfying position (place, share and importance) occupied by the incorporated actives in the managers' perception and preoccupations, as well as in the small and intermediate firms' patrimony represents the consequence of the conjugated action of several objective and subjective factors, such as:

- a. inherent characteristics of the incorporated actives (immateriality, volatility, heterogeneity, diversity, contradictory dynamism of the value, polymorphism, strong subjective load attached to them, quick moral wearing out);
- b. the insufficient interest manifested and the reduced importance given by the managers and specialists in the financial and managerial area and the business area towards these valuable patrimonial resources;
- c. imprecision and ambiguity of the intern and international legal regulations related to it, especially with regard to the recognition, subsequent valuation, devaluation and amortization.

The importance of the incorporated actives in the contemporary economy (post-industrial) consists, generally speaking, in the fact that generation and using them judiciously represent the greatest wealth source and create the largest value-added rate, as it is based on the cheapest and most available resources (factors): imagination, creativity, emotion, feelings, belief, passion, vision etc. of the people (with the condition that they are stimulated and lead in a positive and efficient way, by consolidation, good-will, harmony and synergy among all those that work together and / or have interests in the firms activity - *Stakeholders*): shareholder, investors, managers, employees, state institutions, creditors, suppliers, clients, local communities, mass-media etc.

What else, more than the factors enumerated above, create letters patents, well-known brands, know-how, secrete prescriptions, high quality products, prestige and a

good image on the market, good client relations, sophisticated intellectual products, performing management methods etc.?

A single example, present and well-known, is eloquent enough with regard to this: compared to the level of the turnover of 310 millions Euro of SC Real Madrid SA during 2002 / 2003 season, in the 2003 / 2004 season they registered an increase with over 320 millions Euro, attaining more than 630 millions Euro only by the presence of the famous David Beckham in the team! (came at Real in the summer of 2003). The football allied with the marketing, mass-media, commerce and showbiz under the conditions of the globalization, generated and exploited the incorporated actives (especially Good Will) and on this basis it creates the value-added for some unexpected shares even from 10 years ago.

This piece of reality is valid, with particular accents from one case to another, for all the business nowadays.

As a matter of fact, we have not randomly named the contemporary economy also “post-industrial”, due to the fact that nowadays it is not of present interest the orientation of the enterprises activity towards the development of the material, quantitative, „hard” components of their assets (lands, buildings, machines, material supplies. Mass production) as in the industrial epoch: nowadays what prevail are the elements of the incorporated, intangible, „soft”, assets exemplified above.

Defining, recognition, valuation and revaluation incorporated actives are regulated by the Romanian legislation having as referential base the International Accounting Standards (IAS), the International Financial Reports Standards (IFRS), applying guides and their interpretation, EU Directives concerning the matter, as well as The International Valuing Standards (IVS).

An **incorporated immobilized active** is a non-monetary identifying active, with no material support and maintained for using it in the production or assets and services process, in order to be hired by third parties or for managerial purposes. IAS 38 “Incorporated Actives” are not applied:

a) the incorporated actives that are covered by another International Accounting Standard, given their specific type; in this sense, we exemplify: the incorporated actives that are obtained by an enterprise, during the development of the usual activities, for sale. For this, it is applied IAS 2 “Stocks” and IAS 11 “Building Contracts”;

b) delayed tax actives (see IAS 12 “Profit Tax”);

c) leasing contracts regulated by IAS 17 “Leasing”;

d) actives resulted of the employees’ benefits (see IAS 19 “Employees’ Benefits”);

e) commercial fund resulted from the a combination of enterprises (see IAS 22 “Combination of Enterprises ”);

financial actives, such as they are define in IAS 32 “Financial Instruments.

In this spirit of the regulations in effect, there are considered immobilized actives those which are destined to being used on a continuous base, for the development of the entity’s activity. They are generated by benefits and, at the same time, exist in the entity’s patrimony on a period longer than one year¹.

¹ Constantin Staicu (coordinator) – *Financial Accounting According to the European Directives*, Universitaria Printing House, Craiova, 2006.

In the spirit of the Law no. 82/1991, it is adopted the following detailed dissertation of the balance sheet of the incorporated immobilizations:

- constitution expenses;
- development expenses;
- concessions, patent acts, licenses, brands, rights and similar actives;
- commercial fund;
- other incorporated immobilizations;
- advances and incorporated immobilizations in process.

In their activity, the enterprises often spend or make debts for: acquisitions, development, maintenance or extend of some incorporated resources, such as: projection and implementation of new processes and systems, licenses, intellectual properties, market knowledge and trade marks, scientific or technical knowledge, etc. In all these examples there may be observed the consistent efforts performed by the unity that still do not cover a tangible form¹.

In order for an incorporated active to be recognized in financial situations, it is necessary that it fulfils simultaneously two requirements, respectively:

a. the fulfilment of the two conditions of the definition of an incorporated active:

- **identifiability** (name and short description) and **separability** (the possibility of the owner enterprise to use, hire, change it for a separate, individual, independent element or to allot the future benefits generated by the respective incorporated active);

- **control** over the corporate active, expressed by the enterprise capacity to obtain future economical benefits from the use of the active and to restrict the access of the third parties to those benefits; future economical benefits refers to the income that come either from the sale of products and services to which that incorporated active contribute to or from the reduction of some cost elements.

b. the reunion of the two criteria of the recognition of the incorporated active:

- the real possibility that the future economical benefits, generated by the incorporated active, to be obtained by the owner enterprise;

- the cost (initial value) of the incorporated active may be estimated in a credible way (correct).

If one of the mentioned criteria is not fulfilled, then the expenses with its acquirement and production from proper resources, is recognized as an expense, the moment it is performed. The exception is made by the commercial fund, that is recognized as an incorporated immobilization at the enterprises combination by acquisition.

Other criteria of recognizing an incorporated active is the determination of the value, of its costs. Including in the case of the incorporated immobilizations it is precise the accurate valuation of the cost.

The incorporated actives valuation also knows a series of rules, in different moments when it imposes itself.

The entrance of the incorporated immobilizations can be performed by: acquisition, production, contribution to the registered capital by means of change, donations or subsidies. For each of these cases of entrance, the valuing problem is formulated differently.

¹ Victoria Bărbăcioru, Sorinel Domnișoru, Radu Bălună – *Financial Accounting I*, Universitaria Printing House, Craiova, 2006.

a) Thus, **the incorporated active acquired separately**, are valued at the acquirement cost, which represent the sum of all the efforts of buying, transport and setting to work (buying price, plus irrecoverable taxes, plus any direct expense for setting them to work).

Concerning the acquisition of incorporated immobilizations, there appear a series of particular elements. Thus, there exist incorporated active that are acquired separately and incorporated active that are acquired as part of enterprises combination. In the case of **an incorporated active acquired in an enterprises combination, the cost of that active** is based on the **just value on the date of the acquirement**. For the separate recognition of the cost of the incorporated active acquired in an enterprises combination, it is precise the professional rationalism, in order for the valuation to be performed with enough fidelity. The prices estimated on a market may be the most credible valuation of the just value. The market price is usually the price of the current sale. If no other prices are available, it may be used the most recent similar transactions price, if no significant changes appeared in the economic field. In case the just value cannot be faithfully estimated, the respective active is not admitted as an incorporated active independently, but it is included in a commercial fund.

To add more with regard to the incorporated immobilizations acquisitions, there may appear situations in which the payment of the acquired active is postponed beyond the crediting term. In these cases the difference between the value of the assets and effective payments represent an expense with the respective period interest. Moreover, there is also the possibility that the afferent interest of a long term credit, given for active acquisition, to be capitalized, that is to enter the active cost competition.

b) Another method of obtaining incorporated immobilizations is **concluding leasing contracts** (specifications in IAS 17 "Leasing"). In this situation, **the entering value of the active** in the beneficiary accounting (occupier) depend on the type of contract or the form of leasing. Thus, in case the occupier in not a resident, in the operational leasing contract, the entrance of the active if performed on the day of the property transfer, at the residual value and the afferent customs. In the financial leasing contracts, the recognition of the active begins the moment of its utilization (that is, the moment it purchases economic benefits), the valuation being performed at the minimal between the just value and the actualized value of the minimal leasing prices.

c) Another way of entering of the incorporated immobilizations is represented by the **contribution in kind to the subscribed social capital**. Under this form, the valuation is performed at the just value of the actions received in exchange of the active, which equals the just value of the active.

d) the incorporated active may be **acquired by means of a governmental subvention**. This method may appear when there is a transfer or governmental allowance of incorporated active, such as: the rights of landing on the airport, licenses for operating the radio or TV stations, importation license, etc. The registration value is usually the just value. In case it is not possible, the society initially recognizes the active at its nominal value to which it is added any expense that is direct related to the preparation of the active for use.

e) The incorporated active may enter by means of **exchange with other active**. The cost of such an element is measured at the just value of the giveb active, adjusted with the sums of money paid / collected.

f) The incorporated immobilizations may be **achieved as a result of its own production**. It is difficult to state if an incorporated active, generated internally, is

qualified for recognition. IAS 38 specifies that: "the commercial fund, the brands, the marks, the publications titles, the client lists and other similar actives, produced by self effort of the respective enterprise, are not recognized as incorporated actives". This point of view of excluding the above mentioned elements, is due to the fact that they do not fulfill one or more of the recognition criteria of the immobilized actives, such as: identificability, control and future benefit generation, being also difficult to determine the truthful active cost. In many cases, the cost of internal generation may not be separated from the maintenance cost or of the increasing commercial fund cost.

In order to decide if an incorporated active, internal generated, combine all the criteria for recognition, an enterprise split the its generation process in two stages¹:

- a) research stage;
- b) development stage.

If the enterprise cannot distinguish between the two stages for creating an incorporated active, the enterprise treats the expense with that project as if it were realized only in the research stage.

IAS 38 paragraph 42, settles that, in the case of an incorporated active, **the research stage generates only expenses of the period**. During this stage, no incorporated active is recognized, as it cannot be demonstrated that that active will generate future benefits.

The development stage of the project is more advanced than the research stage and, as a result, an enterprise may, in certain cases, **identify an incorporated active** and demonstrate that the active will generate presumable future economic benefits. So, the development stage imposes the recognition of an incorporated active, if and only if an enterprise is able to demonstrate the following **conditions that must be fulfilled cumulatively** (IAS 38 paragraph 45):

- a) the technical do ability for finalizing the active will determine its availability for sale;
- b) the intention of finalizing an incorporated active in order to be use or sold;
- c) the ability of using or selling the incorporated active;
- d) the way the incorporated active will generate potential future economic benefits (such as: the existence of a market or the estimation of its internal utilization);
- f) the enterprise ability to faithfully value the expense attributed to the incorporated active during its development.

The cost of an incorporated active internally generated, estimated since the day of the active's recognition, and includes (IAS 38 paragraph 54-55):

- material and service expenses spent at the respective active generation. Remember that: the loss resulted from the exploitation of the active aroused before the active realized the planned performances and the inefficiencies identifies in the first stages are excluded;
- the wages and other expenses connected to the direct hired personnel (such as: training personal expenses with active exploration purposes);
- any expense attributed directly to the active generation, such as the taxes for registering a legal right or the amortization of the patents and licenses that are used in order to generate the active;

¹ Victoria Bărbăcioru, Sorinel Domnișoru, Radu Bălună – *Financial Accounting*, Universitaria Printing House, Craiova, 2005.

- management expenses that are needed in order to generate the active and that may be allotted on a consistent and reasonable base (for example: an allowance for the corporate immobilizations devaluing, insurance and rent and bonus). There are excluded the management expenses for the commercialization or general management, in case they cannot be attributed directly to IAS 23 "Oblige Costs", settles the criteria for the interest recognition as a component of the incorporated active internal generated cost.

If **the initial value** of any incorporated active rise no estimation problems given the cost (of acquisition or production) or the just value, settled by a valuing expert (in the case of the social capital contribution or in the case of subsidies, financing, donations) – except the cases when there was registered an adjustment for devaluing, the problems appear in the case of the **subsequent revaluations**. The Romanian Legislation (Accounting Law no. 82/1991, re-published in the Official Monitor no. 773/24.08.2004) foresees that „*the revaluation of the incorporated actives is performed, except the cases foreseen by the legal regulations, at their just value*”.

The first problem that is foreseen is that for the incorporated actives there is an exception foreseen in the legal regulations (OMFP 1752/2005). In this order it is stipulated that the subsequent valuations are to be performed starting with the historic cost, less the amortization and the adjustments for the devaluation, cumulated. This method is inspired by the accounting treatment in base of what was settled by IAS 38.

The second problem is related to the fact that the application of the alternative accounting treatment at the moment of revaluing the incorporated actives starting with their just value (foreseen by the same IAS 38), is not only forbidden by the regulations in our country, but also perceived as a little further in time until the adoption, mainly because the just value must be reported at an active market.

Thus, IAS 38 foreseen the alternative treatment (permission) for valuing the incorporated actives the revaluated sum, (just value), less any subsequent amortization cumulated and any loss resulted from the devaluing subsequently cumulated. Anyway, this treatment is allowed if and only if the just value can be determined by means of reports at an active market for the incorporated active. Furthermore, once the enterprise chooses this treatment, it is required that the revaluations were performed pretty regularly, so that the accounting value at a given moment were not significantly different from the one to be determined using the just value at the time of the balance sheet, and afterwards the differences from revaluing would be recognized in the profit and loss account or directly in its own capital.

For more precision, we define **the just value** as the sum for which the active may be exchanged, willingly, between the parties that are aware of what is happening and during a transaction in which the price is objectively determined.

The greatest impediment in the path of applying the alternative treatment for valuation is the inexistence of an active market, defined as being that market where there are the following conditions:

- a. the elements commercialized within the market are homogenous;
- b. there is always interested purchasers and sellers (there exists a sufficient transactions volume);
- c. the price is available to the public.

Recognition of certain subsequent expenses

The subsequent expenses with an incorporated active, after buying and finalizing it, must be recognized the moment they are performed, except the following cases:

a) when the expense will permit the active to generate future benefits above the initial standard foreseen (in this situation, the subsequent expense is part of the cost of the incorporated active that respect the recognition criteria);

b) this expense can be faithfully estimated and attributed to the incorporated active.

In general, it is difficult to estimate the level in which the subsequent expenses increase the afferent benefits subsequent to an incorporated active, a subsequent expense, necessary for the client list actualization, may lead to the increase of the future benefits level of all the enterprise activity. In many countries practice, there is the option of recognizing as expenses of the period, of the subsequent input related to the brands, emblems, publication titles, client list, etc.

A performed expense that is considered a period expense cannot be considered an incorporated active cost component. Examples related to it: constitution expenses, expenses with the publicist activities, with professional interests activity; expenses for the partial or total reorganization of an enterprise activity, etc. According to the precautions of the regulations approved by OMFP no. 1752/2005, the constitution expenses represent incorporated imobiliarizations inscribed in the balance sheet, the national legislation allows it. The constitution expenses may consist in a series of establishment inputs, such as: secretariat and juridical expenses established for a legal entity; expenses of opening new facilities or business; expenses with the new products and processes launching.

Schedule of assets and liability valuation

In the balance sheet, the incorporated actives are prominent by two modalities:

- basic accounting treatment
- alternative accounting treatment allowed.

The basic accounting treatment¹ implies the recognition of the schedule of assets and liabilities of the incorporated actives cost, less the cumulated amortization and the value devaluation.

Alternative accounting treatment, implies that, after the initial recognition, an incorporated active is accounted at the revaluated value, in other words, the just value at the revaluation date, less the cumulated amortization and any loss resulted out of the accumulated devaluation, subsequent to the revaluation. The just value must be determined by reporting it to an active market. The revaluation must be performed regularly in order that an accounting net value would not substantially differ from the one that could be determined by means of the just value at the balance sheet date.

The alternative treatment assumes:

- revaluation of the incorporated actives that has not been prior recognized as actives;
- the initial recognition of the incorporated actives to other value than their cost.

In conclusion, nowadays, the economic agents are not stimulated to invest in the incorporated immobilized actives development, as they cannot be presented in the

¹ Victoria Bărbăcioru, Sorinel Domnișoru, Radu Bălună – *Contabilitate financiară*, Universitaria Printing House, Craiova, 2005.

financial report at the just value, updated, credible, because of the lack of existence of a legal base, owing to the lack of a specific active market. We consider that this factor has a “vicious circle” effect (except the investments, transactions) and, consequently, the accentuated inhibition of the economic agent’s interest for the incorporated immobilizations investments and, by this, the reduction of the Romanian firm competitiveness.

The solution for this problem could also come from the legislative: fiscal stimulants for material investments, making the revaluation frame flexible by means of adopting the alternative treatment (for certain cases and specific situation).

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